

VZCZCXRO1087
RR RUEHBC RUEHDA RUEHDE RUEHIHL RUEHKUK
DE RUEHLO #3186/01 3541727
ZNR UUUUU ZZH
R 191727Z DEC 08
FM AMEMBASSY LONDON
TO RUEHC/SECSTATE WASHDC 0749
INFO RUCNRAQ/IRAQ COLLECTIVE

UNCLAS SECTION 01 OF 03 LONDON 003186

SENSITIVE
SIPDIS

E.O. 12958: N/A

TAGS: [EPET](#) [EINV](#) [ECON](#) [IZ](#) [UK](#)

SUBJECT: IRAQ PETROLEUM CONFERENCE 2008: DIALOGUE,
CAUTIOUS OPTIMISM ON OPPORTUNITIES IN IRAQ'S OIL SECTOR

¶1. (SBU) Summary. Iraq Petroleum 2008, held in London December 1-2, 2009, was a good opportunity for Iraqi officials, representatives from international companies, and participants from other governments to discuss the current situation in Iraq's petroleum sector, focusing particularly on investment opportunities. Presenters included a number of veterans of Iraq's oil sector, as well as outside experts from the petroleum industry and elsewhere. The speakers covered the strategic outlook for Iraq's petroleum sector, upstream and downstream investment prospects, the role of the international oil companies (IOCs) in Iraq's development, and the political, financial, and legal aspects of the petroleum sector. All speakers and participants agreed that IOC involvement is vital to building up Iraq's oil and gas sectors, and there was broad consensus that the GOI needs to find the right balance of state control and IOC risk/reward in future contracts to maximize the potential of Iraq's resources. The recent precipitous drop in world oil prices added urgency to calls for developing Iraq's petroleum sector. There was wide agreement that the time is right for progress on national hydrocarbons legislation and development of the oil and gas sectors, while acknowledging the difficulty of the tasks ahead. End summary.

Iraq's Petroleum Sector: Present and Future

¶2. (U) Many speakers noted that Iraq's petroleum sector is significantly underdeveloped, due largely to years of neglect and mismanagement through three wars and the sanctions period, as well as the departure of many qualified technocrats in 2003. Similarly, many mentioned declining production in the South as a significant impediment to Iraq's economic growth. Often in the same breath, however, many speakers pointed to the enormous potential of Iraq's petroleum sector, pointing to its 115 billion barrels of proven crude oil reserves - more according to Iraqi estimates - and 1.5 trillion cubic feet of natural gas reserves. One speaker said, "The market will take anything Iraq can produce." Another speaker observed that Iraq is uniquely placed as potentially the largest incremental crude oil producer in the world and should exploit that to the country's benefit. Advisor to the Prime Minister and former Oil Minister Thamir Ghadban and others pointed to the need for a national energy strategy, which would help Iraq comprehensively and rationally deal with its substantial resources. The GOI continues to tout six million barrels per day (MBPD) as the 10-year crude oil production target.

¶3. (U) The upstream and downstream development and investment opportunities in Iraq are significant, conference participants agreed. Not only are there opportunities for currently-producing oil and gas fields, some of which are super giants, but there is also significant exploration potential throughout Iraq. Speakers pointed to the recently-begun tender process for some of Iraq's oil and gas fields, as well as plans to offer more fields and exploration blocks in future tenders. Mustafa al-Jarrah of the Iraqi Ministry of Industry and Minerals noted that there are

significant opportunities in petrochemicals too. Many noted, however, that the keys for additional development and investment are the legal and regulatory framework that the GOI chooses to implement, as well as the structure of the contracts offered by the GOI.

Iraq and the IOCs

¶4. (U) Much of the conference focused, in particular, on how much IOC and national oil company (NOC) involvement is needed in Iraq. Speakers and participants outlined the long history between Iraq and the IOCs, from pre-nationalization to post-2003 technical assistance, making it explicitly clear that Iraq's oil and gas resources belong to Iraq, and that Iraqis have no desire to be controlled by outsiders. That said, there was unanimous agreement that the IOCs offer technical expertise, technological advances, and financial resources that the Iraqis simply don't have in their domestic petroleum sector. Falah al-Khawaja, a former Director General at the State company for Oil Projects, argued that the global petroleum sector is very different now than it was in the 1970s, and that Iraq can now deal with major IOCs and NOCs from a position of strength. As such, the GOI needs to figure out the extent of its engagement with the IOCs, and how to present that engagement to the Iraqi people to avoid the impression that Iraq's oil sector is run by outsiders. Kjetil Tonstand of Statoil-Hydro argued that Iraq must determine how it will attract the right IOCs to develop Iraq's petroleum sector. Dr. Abdul Hadi al-Hassani, Vice Chairman of Parliament's Oil and Gas Committee, was a particularly strong advocate for greater leadership -

LONDON 00003186 002 OF 003

particularly from the Iraqi Council of Representatives - in soliciting popular support, as well as an improved banking system, and more domestic and international transparency in the oil and gas sectors.

¶5. (U) Many of the IOC representatives expressed some indifference toward the conference, believing that it covered already well-trod ground. They were also unimpressed by the then-upcoming December 5-7 Energy Expo in Baghdad. There continues to be frustration among IOC representatives about how the GOI is handling its oil and gas contracts. IOC representatives argue that the contract structure brings a lot of risk with relatively little upside, and it remains to be seen how closely the GOI will hew to the announced schedule of the first contracting round.

Bring Back INOC

¶6. (U) Many speakers and participants lamented the current structure of Iraq's petroleum industry, which they see as too political and centrally-controlled by the Oil Ministry. One solution that received nearly unanimous backing was the reconstitution and increased role of the Iraqi National Oil Company (INOC). Many Iraqis in attendance spoke highly of INOC and its history of managing Iraq's oil sector, pointing to the nearly four mbpd in production reached at the end of the 1970s. The repeated argument was that INOC would manage the petroleum sector better than the Oil Ministry, and that the operating companies should come under INOC's umbrella. Dr. al-Hassani argued that the GOI must fund INOC properly to bring it to parity with IOCs. Fadhil Chalabi, former acting Secretary-General of OPEC and now with the Centre for Global Energy Studies, cautioned that INOC must remain apolitical and be run on a commercial basis, akin to other commercial state-owned oil companies like Statoil-Hydro or Petrobras.

The (Unpopular) Heads of Agreement with Shell

¶7. (U) Participants express nearly unanimous concern about the recently-signed Heads of Agreement (HoA) on southern gas

between the GOI and Royal Dutch Shell. Though the Iraqis present were content with the joint venture arrangement, others cited problems including a lack of transparency; the fact that HoA precludes the GOI from talking to other IOCs about gas in the coming year, thereby creating a monopoly; the HoA's review of export options when domestic concerns were a priority; and the fact that the HoA dictates that the joint venture must sell Iraqi gas domestically at international market rates.

Political, Financial, and Legal Ramifications

¶8. (U) While noting the many political obstacles to the development of Iraq's petroleum sector, many of the Iraqis present indicated that the current political and economic situation may produce the right incentives for compromise on necessary hydrocarbons legislation. There was a great deal of optimism among many at the conference for Oil Minister Shahrastani's late November visit to Erbil to discuss adding Kurdistan Regional Government (KRG)-produced crude oil to the Iraq-Turkey export pipeline. While many called the visit a breakthrough, Ghadbhan noted that the nature of the KRG's contracts and revenue sharing had not yet been discussed. Additionally, former Oil Minister Ibrahim Bahr al-Uloom was one of many who noted that there is currently a positive environment for agreement on hydrocarbon legislation. Some, including Dr. Al-Hassani, even mentioned passing a hydrocarbons framework law by spring 2009.

¶9. (U) Given the recent precipitous drop in world oil prices, many speakers noted the significant shift in the GOI's fiscal outlook. The GOI is likely to run a real deficit of USD 15-25 billion in 2009, and will have difficulty funding necessary capital investment projects beyond 2009, if oil prices remain around current levels, participants agreed. Dr. Colin Rowat of the University of Birmingham argued that this presents the GOI with an opportunity to assess current and capital expenditures based on rate of return, rather than simply providing money when it is requested, as was its general practice during the oil price boom. Ghadbhan noted that declining government revenue has only added on the pressure on the Oil Ministry to increase production.

¶10. (U) As many speakers reiterated, the Oil Ministry's efforts to increase production take place amidst legal and regulatory ambiguity over who controls the development, management, and revenues of Iraq's petroleum sector. All

LONDON 00003186 003 OF 003

legal experts harkened back to Articles 111 and 112 of the 2005 Constitution and the legal ambiguity surrounding them. Dr. Carole Nakhle of the Surrey Energy Economics Centre and ¶J. Jay Park of Macleod Dixon LLP discussed some of the GOI's legal options, including the structure of contracts and the constitutional issues involved. Nakhle urged the GOI to come up with a legal framework similar to that adopted for the North Sea, which would allow the government to maintain control over the resources but would also give companies maximum flexibility to develop Iraq's oil and gas fields. Interestingly, Dr. Al-Hassani pointed out that upstream (and some downstream) activities could be decentralized to the regions/provinces, although the legal questions still have to be answered.

Comment

¶11. (SBU) The conference demonstrated that the Iraqis are thinking seriously about the issues that face them, but it is unclear how much traction these ideas have among Oil Ministry leadership. It was somewhat encouraging to hear Iraqi participants speak so highly of IOC involvement and focus on development and involving the domestic Iraqi private sector in the petroleum sector, although they were unable to provide

many specifics ways to solve their problems. Even in the face of some optimism that contract tenders have been offered and that the apparent thaw in GOI-KRG relations can bring about national hydrocarbons legislation, the mood at the conference was somewhat subdued, with many participants acknowledging that the GOI continues to face many of the same issues it has for quite some time.

Visit London's Classified Website:

http://www.intelink.sgov.gov/wiki/Portal:Unit ed_Kingdom

TUTTLE